

# Economic Concepts & Systems related to Business Environment

**AAT Level I**  
ECN - Economics

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## **CHAPTER 01**

### **Introduction to Economics**

#### **What is Economics?**

Economics refers the study of human economic behavior in relation to production, distribution and consumption of goods and services and also about how (optimum) allocation of resources can be achieved.

#### **Why economics is known as Social Science?**

Economics is known as social science because it applies scientific application (steps). It means collection data, evaluation and finally taking an appropriate decision in order to solve human economic problem. Therefore it is a research of human economic behavior.

#### **Micro Economics - Macro Economics**

##### ✓ Micro Economics

It is known as the study of an economy deeply and individually by dividing it into number of parts.

##### **Example:**

- Theory of demand
- Theory of supply
- Markets
- Theory of production

##### ✓ Macro-Economics

It is known as the study of whole economy without dividing it into number of parts.

##### **Examples:**

- Inflation rate
- Investments
- Interest rate
- Economic growth rate
- Unemployment rate etc.

## Positive Economics - Normative Economics

### ✓ Positive Economics

Positive Economics can be explained as the statement about the real economic behavior on the current situation.

Therefore it is all about real facts about what has happened and what is happening in an economy.

### **Example:**

- If price of particular product increases, quantity demanded will be decreased.
- Recently VAT rate has reduced to 8%

### ✓ Normative Economics

It can be explained as the statement related to research about what has to be happened and how it could be happening in the real world. Therefore, it is about providing opinions or ideas or expectations given related to an economy.

### **Example:**

- Could maintain social justice by reducing poverty.
- Could achieve full employment by optimum usage of resources.

## Human Needs and Human Wants

### ✓ Human needs

It can be defined as the minimum basic things (essentials) that should be consumed to survive in the world.

Ex: Food, cloth, shelter, education etc.

Economic needs are fulfilled by consuming goods and services

Psychological needs are fulfilled by love, kindness, supportiveness etc.

### ✓ Human wants

The ways and means to satisfy one's needs

Ex: Rice, bread, string hoppers to fulfill need of food

### The differences of needs and wants

Human Needs	Human Wants
Limited	Unlimited
Primary	Secondary
It is must to fulfill	Not a must to fulfill
Cannot be influenced through advertising	Can be influenced through advertising

## Factors of Production


### 1. Land

All the natural resources which are gifted by nature that can be used in production process.

Example: land, wild animals, sunlight, river, mountain etc.

#### Characteristics of land

- Natural factor
- Comparatively inelastic in supply
- Limitation to mobility
- Possibility in improving productivity
- Reward is rent

### 2. Labour

The mental and physical activities or performance given by human beings in the production process.

#### Determinants of labor force

- Size of population
- Health and physical strength
- Education, experience, training and skills etc.

#### Characteristics of labour

- Living production factor
- Can be utilized by repeatedly
- Possibility to improve productivity through education ,training and experience
- Not homogeneous
- Reward is salaries or wages

### 3. Capital

All the manmade assets which can be used in production process.

Example: Building, machinery, motor vehicles, equipment, IT and computers etc.

#### Characteristics of capital

- Human made factor
- Real factor
- Can be utilized again and again
- Productive factor
- Reward is interest

### 4. Entrepreneurship

It is an activity of organizing the factor of production to do production process effectively.

#### The functions of entrepreneurship

- Making policy decision
- Ability to organize and conduct production activities
- Risk taking
- Introduction of new products

#### The characteristics of entrepreneurship

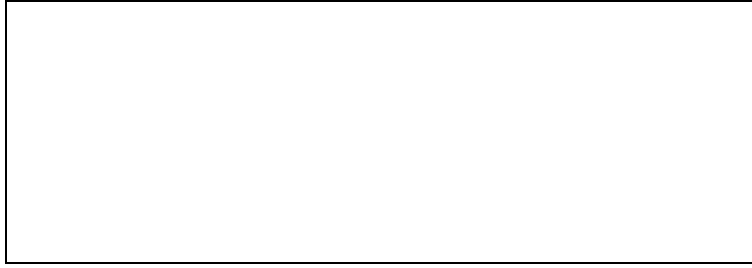
1. Human capital
2. Ability to face challenges.
3. Risk taking and Innovation
4. Far-sightedness
5. Patience and self- confidence

### **Scarcity**

It is a gap in between of the limited available resources and unlimited human wants. Therefore there is a shortage in availability of resources to satisfy unlimited human wants.

### **Opportunity Cost**

The value of next best alternative forgone in order to achieve the best alternative.



Example: Sacrificing current savings to do current consumption.

### Instances where the opportunity cost is zero

- ✓ Excess in the availability of resources e.g.: free goods
- ✓ If resource has on unique usage
- ✓ During the time of using unused (under employed) resources.
- ✓ At the time consuming public goods

### **Importance of Economics**

1. Maximum of utilization of resources
2. Obtaining economic growth and development
3. Achieving full employment level
4. Maintaining general price level stability
5. Improving standard of living by reducing poverty

### **Production Possibility Curve (PPC)/Production Possibility Frontier (PPF)**

#### Characteristics /Assumptions

1. Maximum combination of two different goods.
2. Resources are limited.
3. Resources have alternative uses.
4. Resources are fully employed.
5. Existing technology remains constant.

There are 3 Shapes of PPC

1. Straight line PPC
2. Concave to origin PPC
3. Convex o origin PPC

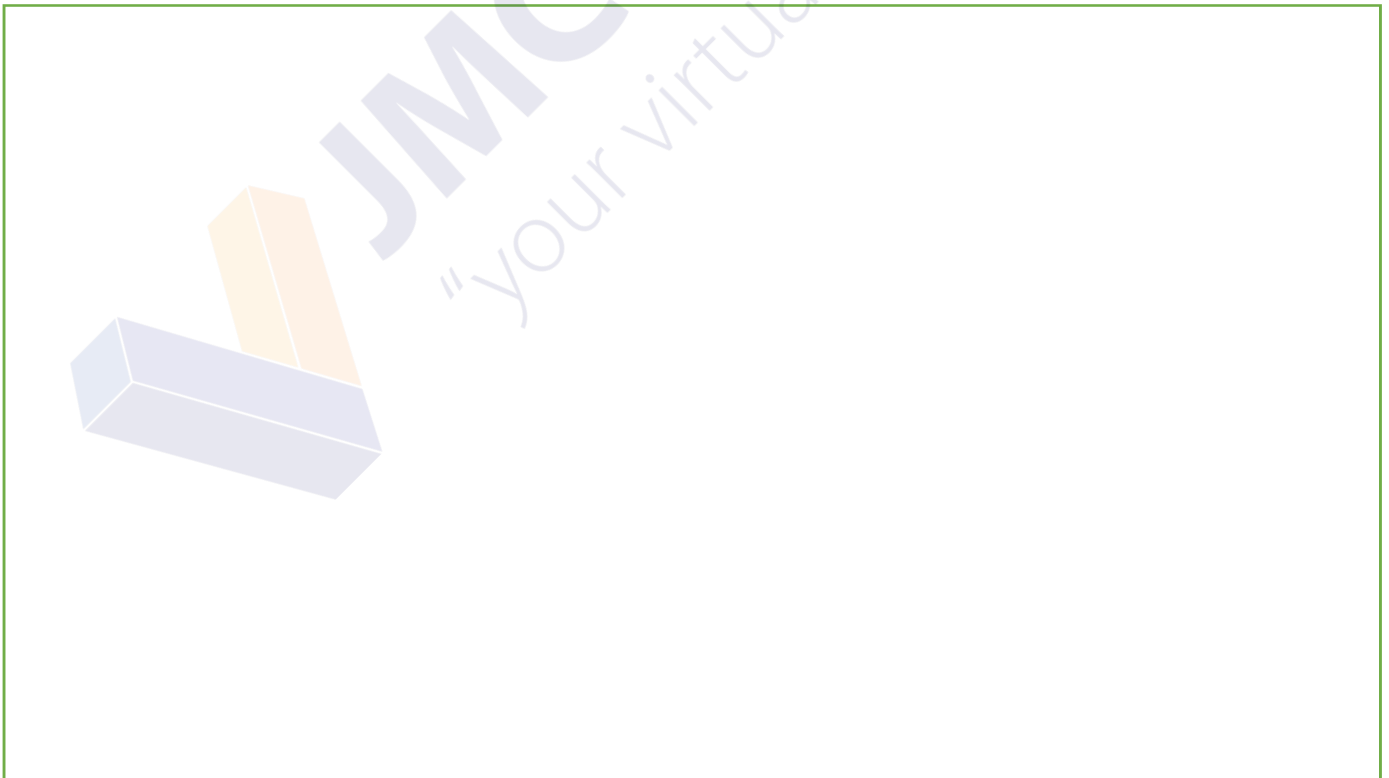
## Straight line PPC



During the given period of time while we try to increase one particular good (X Good) in an equivalent amount, we must to sacrifice another type of good (Y Good).

Therefore the sacrificing amount of 'Y Good' remains constant .It is known as constant opportunity cost which can be illustrated by straight line PPC.

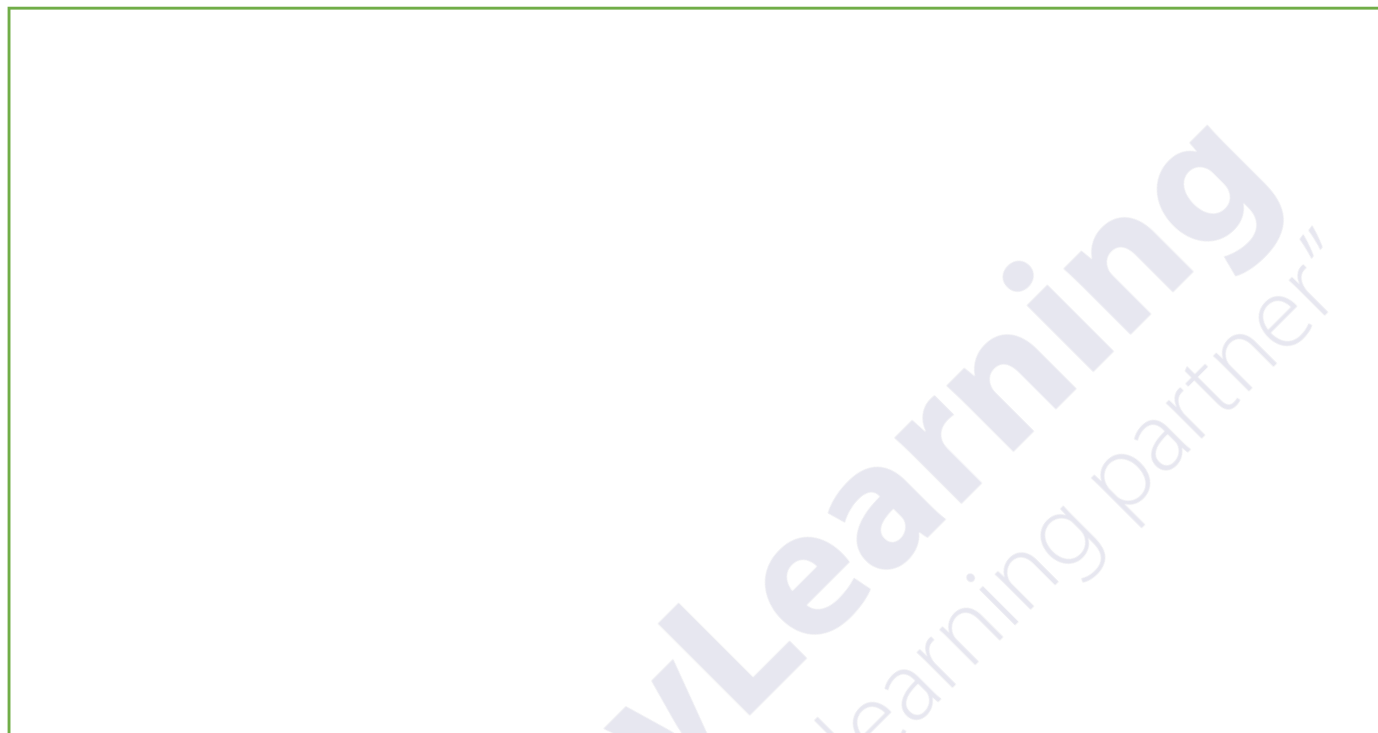
## Concave to origin PPC



During the given period of time while we try to increase one particular good (x Good) in an equivalent amount we must to sacrifice another type of good (Y Good).

Therefore the sacrificing amount of 'Y' Good is increasing .It is known as increasing opportunity cost which can be illustrated by concave to origin PPC.

### Convex to origin PPC




During the given period of time while we try to increase one particular good (x Good) in an equivalent amount, we must to sacrifices another type of good (Y Good).

Therefore the sacrificing amount of 'Y' Good is decreasing .It is known as decreasing opportunity cost. Which can be illustrated by Convex to origin PPC


Illustration following economics situation in each PPC:

1. Full employment
2. Un- employment
3. Reduction in unemployment
4. Scarcity
5. Economic growth
6. Partial economic growth ( One side economic growth )
7. Economic recession
8. Economic degrowth or decline
9. Introduction of new technology
10. Migration Experts
11. 25% increase in X Good



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## Basic economic problems

1. What and how much to produce? (Problem of allocation of resources )
2. How to Produce? (Problem of production )
3. Whom to produce (Problem of distribution)

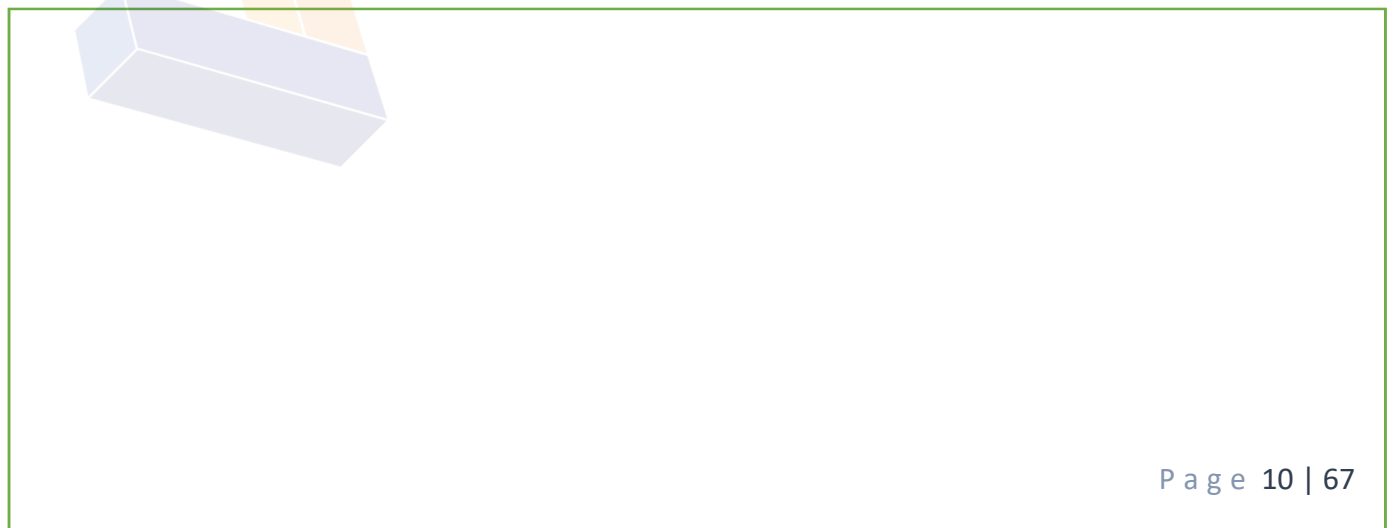
What and how much to produce?

This is the problem of which production and how much limited alternatives use resources should be allocated.



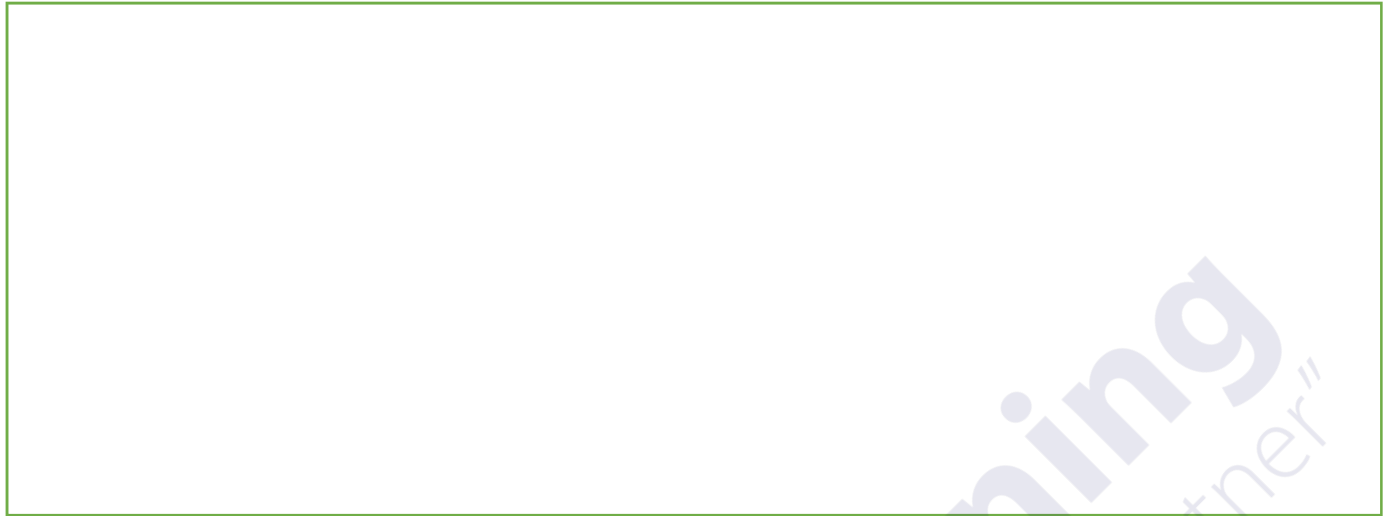
How to produce?

It is the problem of selecting the method of technology to carry on the production process effectively.



Whom to produce?

This is the problem of distribution among households who are the owners of factors of production of given output.



### **Economic systems**

Any mechanism developed by people living in society with a view to solve basic economic problems faced by any economy.

Basic features of economic systems:

- ✓ Households
- ✓ The government
- ✓ Markets
- ✓ Business sector
- ✓ Labour organization
- ✓ Incentives
- ✓ Legal structure

Classification of Economic systems

1. Free Market economy or Market economy or Capitalist Economy
2. Command Economy or Planned Economy or Socialist Economy
3. Mixed Economy
  - Social market Economy
  - Socialist market Economy

The following areas are considered to categorize above economic systems

1. The ownership of resources/properties
2. The mechanism employed
3. The incentive system

## **How the basic economy problems are solved in different economic system**

### What and How much to produce?

#### ✓ Free market Economy

This problem is solved through the signal given by price mechanism in a commodity market with an objective of maximizing profit. They don't allocate the resources in the production which doesn't give profit.

#### ✓ Command economy

Here the problem is solved through the decision taken by Centrally Planning Committee (CPC) (Government). Therefore the production activities are decided by government officers with an objective of social welfare

#### ✓ Mixed economy

Since there is a partly owned private resources and partly owned public resources, the decisions are taken by both private sector and public sector

### How to produce?

#### ✓ Free market Economy

This problem is solved through the signals given by price mechanism in a factor market with an objective of maximizing profit. They buy comparatively less factor price and more economically effective technology in the factor market.

#### ✓ Command economy

Here the problem is solved through the decision taken by Centrally Planning Committee (CPC) (Government). Therefore the technology activities are decided by government officers with an objective of social welfare.

#### ✓ Mixed economy

Since there is a partly owned private resources and partly owned public resources, the decisions are taken by both private sector and public sector.

### How to produce?

#### ✓ Free market economy

The distribution of production is taken place base on the industrial income (purchasing power) with an objective of maximizing profit.

✓ Command economy

Here the problem is solved through the decision taken by Centrally Planning committee (CPC) (Government). Therefore the distribution activities are decided by government officers with an objective of social welfare.

✓ Mixed economy

Since there is a partly owned private resources and partly owned public resources, the decisions are taken by both private sector and public sector.

Characteristics of free market economy

- 1.
- 2.
- 3.
- 4.
- 5.
- 6.

**Price mechanism**

It is a mechanism of determining factor price in factor market and commodity price in commodity market which is freely decided by the interaction in between of demand and supply in the free market economy.

Functions of price mechanism

- 1. Signaling/leading/providing information

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- 2. Motivation

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- 3. Function of allocation

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### Characteristics of command economy

- 1.
- 2.
- 3.
- 4.
- 5.
- 6.

### Characteristics of mixed economy

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### Goods

Anything which provides positive satisfaction or utility is called goods in economy.

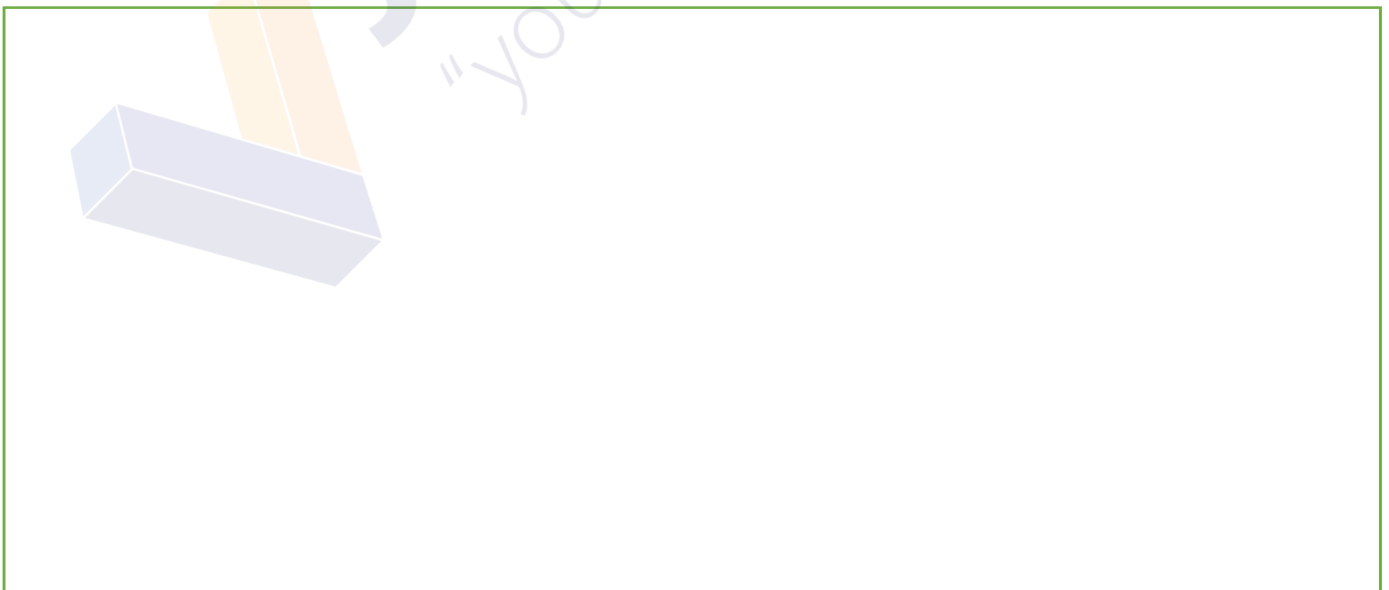
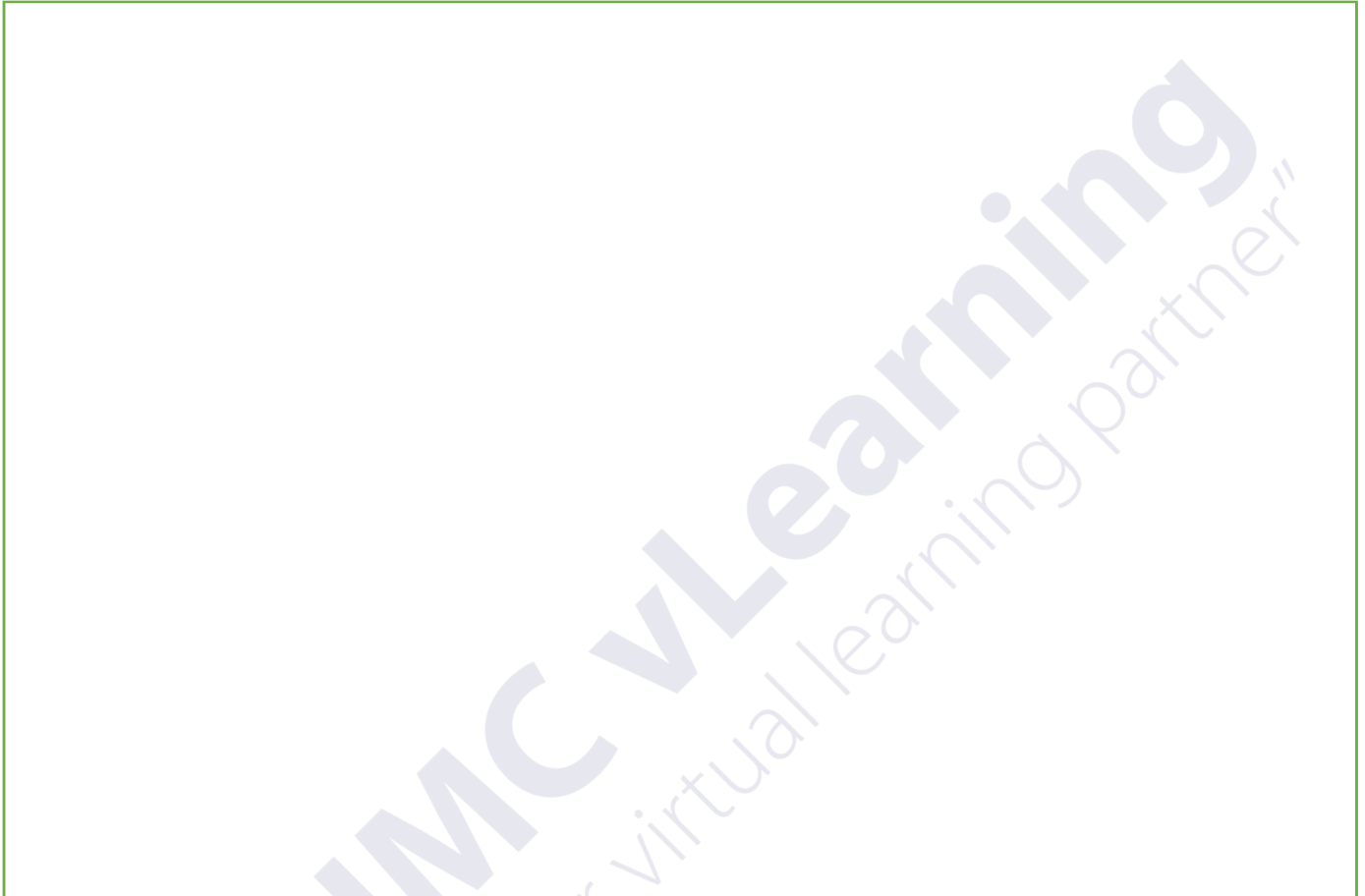


Meanwhile there are some situations where non- economic goods can be economic good.

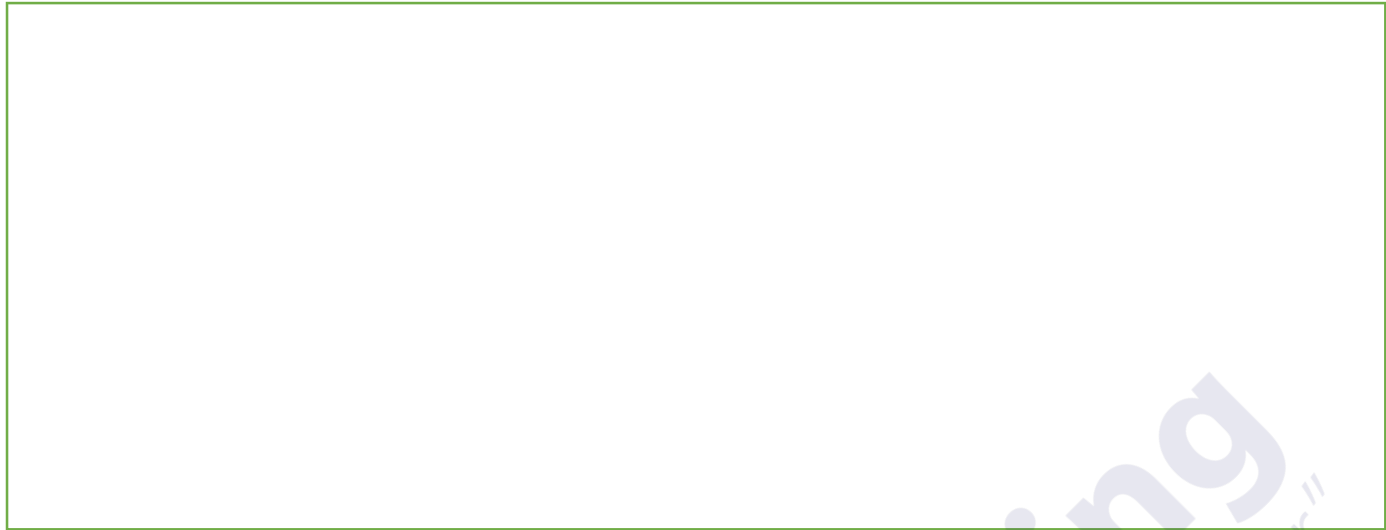
Example:

- Oxygen Cylinder
- Solar panel
- Bottle Water

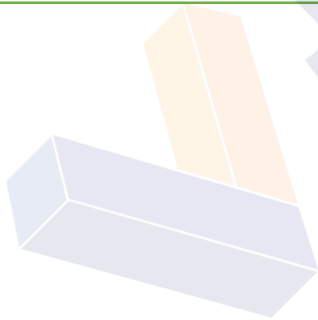
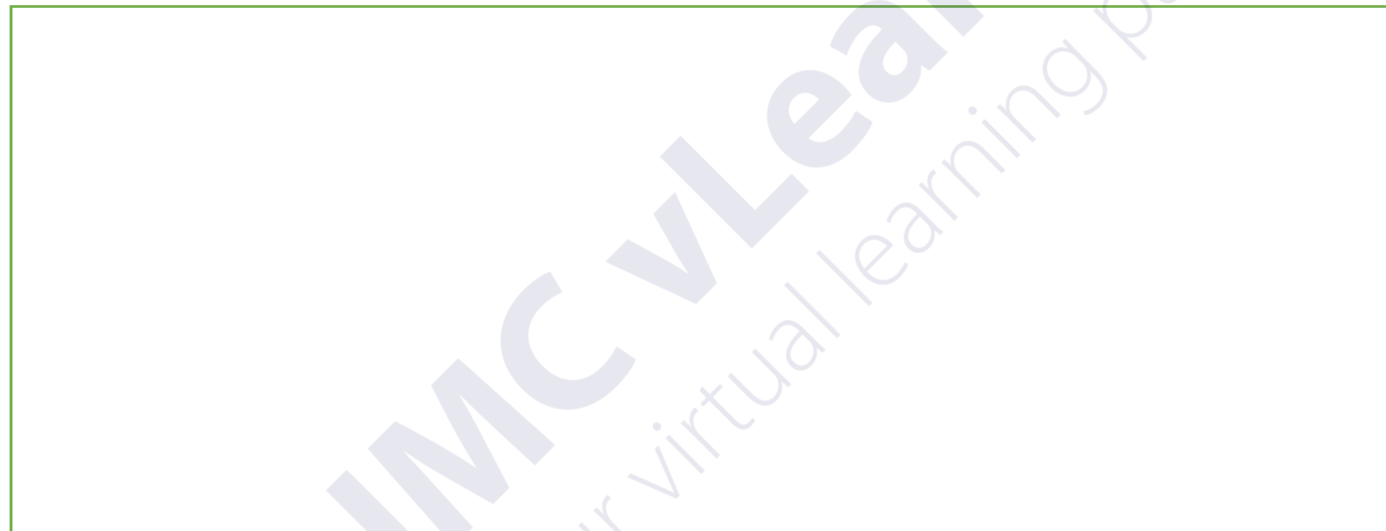
Resources







## The Theory of Demand and Supply 02



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